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Performance Theory and Nonprofit Organizational Effectiveness

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Abstract

This abridged article reports on a review of the literature of performance theory and its relationship to the effectiveness of nonprofit organizations. Specifically, the article explores the challenges in defining organizational effectiveness in the Third Sector due to the wide disparity in the size, scope and mission of nonprofit organizations. The following theoretical models, and their application to the Third Sector, are explored: Agency Theory, Resource Dependency Theory, Group/Decision Process Theory, Stakeholder Theory, Institutional Theory, Policy Governance Theory and Contingency Theory. The review indicates there is not a single theory or hypothesis capable of meeting the challenges of nonprofit governance. Regardless of theory, model or framework of governance deployed, nonprofit organizations must identify their own unique challenges and define appropriate solutions.

There is not a single theory or hypothesis capable of meeting the challenges of nonprofit governance. Each nonprofit must evaluate the available options and select a path based upon its own collection of personalities, culture and external pressures (Brudney & Murray, 1998; Ostrower & Stone, 2009). Regardless of the theory, model or framework of governance, the organization must identify governance challenges requiring the interaction of the board of directors and the chief executive officer (Kreutzer, 2009).

Organizational effectiveness is a term that meets no single definition or scenario in the nonprofit community. The term is difficult to define due to disparities among nonprofit organizations in the United States. Such disparity leads to a broad range of hypotheses regarding nonprofit effectiveness as well as board performance, and according to Brown (2005), such a challenge to determining effectiveness cannot be minimized. Harrison, Murray and Cornforth (2013) note that the changing contextual conditions in which the nonprofit sector operates may potentially disturb the status quo and require organizations to re-evaluate their theoretical approach to governance.

Callen, Klein, and Tinkelman (2003) argue that no single criterion of organizational effectiveness is available that is accepted equally among the nonprofit community. A clear causal mechanism behind a well-performing board and an effective organization does not exist (Mwenja & Lewis, 2009). Mwenja & Lewis maintain organizational performance is ultimately a social construct that makes the development of a single model of measurement of nonprofit effectiveness impossible.

Nonprofit organizational effectiveness, as posited Herman and Renz (2008), is always multidimensional and a matter of comparison. Herman and Renz offered nine key traits to determine nonprofit organizational effectiveness, comparing:

- Multidimensionality,

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- Relating to board effectiveness (but with a lack of clarity),
- Relating to the use of accepted management practices,
- As a social construction,
- Universal “best practices” (that are unlikely to exist),
- Organizational responsiveness as an effective organizational-level measure,
- Distinctions among nonprofits that must be made, and
- The depth and breadth of the analysis that must be considered.

Herman and Renz (2000) hypothesize nonprofit organizational effectiveness is directly related to the effectiveness of the board of directors. It is very difficult to empirically measure the relationship between organizational success and the effectiveness of the board of directors (O'Regan and Oster, 2005).

Callen et al. (2003) indicate a statistical association between organizational effectiveness and the presence of individuals considered to be major donors on the board of directors. That study is limited by its focus on revenue, expenses, and the source of funds. Brown (2005) notes the difficulty of relying on financial performance indicators as a measure of organizational effectiveness because the nature of nonprofits does not allow for a standardized method to relatively measure that performance. Brown maintains that budget size or the amount of revenue generated by a nonprofit does not necessarily indicate that the organization effectively delivers according to its stated mission. Stone and Ostrower (2007) state the research remains inconclusive regarding how a board makes a difference to the organization it governs. Ostrower and Stone (2009) later indicate the necessity for a framework to understand board governance due to the broad diversity of the sector and noted governance research lacks from

a large empirical data study from which to make broad generalizations regarding nonprofit governance.

Theoretical Models

Agency theory

Brown (2005) argues that agency theory is the most significant explanation of how the board of directors improves organizational effectiveness. Agency theory describes a state of conflict between the governing board of directors and the executive, or executive team, who manage the nonprofit organization. If agent/executive director/behavior is not controlled, the principal's goals – the nonprofit mission – may not be achieved (Caers, Du Bois, Jegers, De Gieter, Schepers, & Pepermans, 2006). In the for-profit corporate environment, agency theory protects stockholder interests from potentially self-interested actions among the corporate management team. As identified by Brown, the board in the nonprofit sector protects the organization's mission by connecting the management team's decision-making process to that mission and the values and purpose of the organization. The critical component of agency theory related to nonprofit governance is the delegation by the board to the executive director the responsibility for day-to-day operations with the expectation to manage in the board's best interest; at the same time, the board is responsible for managerial compliance (Miller-Milleson, 2003; Kreutzer, 2009). Wagner (2013) acknowledges agency theory's emergence as a key to success in the non-profit sector, but further states the need to conceptualize governance as the engagement of multiple actors within not only the organization but society in general.

Resource dependency theory

A second major theory of organizational management is resource dependency, wherein the board of directors' primary function is to

connect the organization to the resources essential to its survival and its success by providing board capital, such as financial resources, potential benefactors, advice, and so on (Brown, 2005). The board's ability to deliver capital that will develop and solidify organizational effectiveness is critical to reduce environmental uncertainty and provide access to resources. Resource dependency acknowledges the board of directors' ability to maximize external connections through the leveraging of personal and professional relationships that enhance the organization's reputation as well as expand the donor base (Miller-Millesen, 2003; Kreutzer, 2009; Mwenja & Lewis, 2009). Callen, Klein and Tinkelman (2010) present empirical evidence indicating Agency Theory and Resource Dependency are not mutually exclusive and agree with Miller-Millesen (2003) that no one theory describes the governance of nonprofit boards due to the span and scope of the sector.

Group/decision process theory

Group/decision process theory argues that the most effective governing boards are self-developing, with an emphasis on training and defined membership roles. That development process affects how information is managed, how decisions are made, and how the management team and board of directors interact with one another for the benefit of the organization (Brown, 2005). Critical components of the group decision-making process theory include diversity, board membership, board development through training and the interpersonal relations of those involved (Brown, 2005; Mwenja & Lewis, 2009). Group decision process theory states that for the organization to function effectively, the board of directors, in relation to the management team, must function effectively.

Stakeholder, Institutional and Policy Governance

Stakeholder theory requires systematic attention to stakeholder interests; as part of the individual board member's responsibility, the board must be aware of the community and of the constituencies served (Brown, 2002). The board of directors must not only be cognizant of external stakeholders but it must also be willing to resolve the conflicting interests of those stakeholders (Cornforth, 2003; Kreutzer, 2009). Institutional theory suggests an organization's behavior is determined, in part, by the environment in which it operates is known as institutional theory, which may include environmental norms, laws and regulations, community norms, and governmental contracts (Miller-Millesen, 2003). From a more practical and less theoretical perspective, Carver's (1997) policy governance model identifies the responsibilities of the board of directors. The discipline of this model requires the board to develop policy whenever needed, and to direct management in its execution (Carver, 2002). The policy governance model requires that the board of directors must apply policy in a disciplined manner to every issue it considers it (Carver, 2006).

Contingency theory

Contingency theory rejects the normative, or "one best way," approach to nonprofit management, including a prescriptive list of best practices for success. Instead of a perfunctory adoption of prescriptive norms, an organization capable of adapting governance and management to changing circumstances is most likely to align the two and be successful (Bradshaw, 2009). Ostrower and Stone (2009) developed a contingency-based framework to evaluate nonprofit governance since the internal and external factors determine governance, in part by the board's own circumstances as well as by the circumstances of the organization itself.

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